

SOUTHERN FIRST BANCSHARES INC  
Form 10-Q  
November 04, 2009

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended September 30, 2009

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition Period from                      to

Commission file number 000-27719

**Corporate Election Services**

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**Post Office Box 125**

**Pittsburgh, PA 15230-0125**

**412/262.1100**

March 15, 2005

**Re: Corrected Proxy Card for 2005 Annual Meeting of Shareholders**

Dear Stoneridge Shareholder of Record:

You may have already received your proxy materials for Stoneridge's 2005 Annual Meeting. As printing agent for Stoneridge we made an error printing the proxy card that was not discovered until after the annual report, proxy statement and proxy card had been mailed to you. Therefore, we are sending you the enclosed corrected proxy card, along with this explanation and an apology for any inconvenience our error may have caused you.

What Happened?

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When we printed the proxy cards, we used a draft of the card which was not the final, approved draft.

What Is Different?

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There are two changes in the corrected proxy card you are receiving with this letter. First, the named proxies for the Annual Meeting are Gerald V. Pisani, Joseph M. Mallak and Avery S. Cohen. Second, there are ten nominees for election of directors, including Jeffrey P. Draime, Douglas C. Jacobs and Gerald V. Pisani.

What Should You Do?

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If you have already mailed your proxy card, Stoneridge will disregard it. We ask you to please mark, sign, date and return the enclosed corrected proxy card.

If you have not mailed your proxy card yet, please destroy the proxy card you received with the annual report and proxy statement and use the enclosed corrected proxy card instead.

We take full responsibility for this error and have borne all expenses associated with the reprinting and mailing of the corrected proxy card and the notification of shareholders of record.

Thank you for your understanding.

Sincerely,

/s/ Lang Johnston

Lang Johnston, President  
Corporate Election Services



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[Form of Proxy Card enclosed with the letter was appended to the Company's Schedule 14A, which was filed with the Securities Exchange Commission on March 11, 2005.]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant

to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definitions of accelerated filer and large accelerated filer in Rule

12b-2 of the Exchange Act).

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 3,078,695 shares of common stock, \$.01 par value per share, were

issued and outstanding as of November 1, 2009.

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**PART I. CONSOLIDATED FINANCIAL INFORMATION**

**Item 1. Consolidated Financial Statements**

***SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY***

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**CONSOLIDATED BALANCE SHEETS**

(dollars in thousands, except share data)

	<b>September 30, 2009 (Unaudited)</b>	<b>December 31, 2008 (Audited)</b>
<b>ASSETS</b>		
Cash and cash equivalents:		
Cash and due from banks	\$ 6,916	\$ 4,360
Federal funds sold	21,963	8,800
Total cash and cash equivalents	28,879	13,160
Investment securities:		
Investment securities available for sale	80,775	64,432
Investment securities held to maturity (fair value \$10,132 and \$12,618)	9,795	12,519
Other investments, at cost	9,088	8,461
Total investment securities	99,658	85,412
Loans	569,687	566,607
Less allowance for loan losses	(7,916)	(7,005)
Loans, net	561,771	559,602
Property and equipment, net	16,120	11,701
Bank owned life insurance	13,828	13,369
Deferred income taxes	3,108	3,864
Other assets	9,305	5,871
Total assets	\$ 732,669	\$ 692,979
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits	\$ 494,816	\$ 469,537
Short-term repurchase agreements	5,000	-
Note payable	4,750	15,000
Federal Home Loan Bank advances and related debt	149,675	149,675
Junior subordinated debentures	13,403	13,403
Other liabilities	4,793	5,578
Total liabilities	672,437	653,193
Shareholders' equity:		
Preferred stock, par value \$.01 per share, 10,000,000 shares authorized, 17,299 shares issued and outstanding	15,559	-
Common stock, par value \$.01 per share, 10,000,000 shares authorized, 3,069,760 and 3,044,863 shares issued and outstanding at September 30, 2009 and December 31, 2008, respectively	31	30
Nonvested restricted stock	(17)	(27)
Additional paid-in capital	33,794	31,850
Accumulated other comprehensive income (loss)	990	(1,079)
Retained earnings	9,875	9,012
Total shareholders' equity	60,232	39,786
Total liabilities and shareholders' equity	\$ 732,669	\$ 692,979

See notes to consolidated financial statements that are an integral part of these consolidated statements.

**SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF INCOME**

(dollars in thousands, except share data)

	For the three months ended September 30, 2009		For the nine months ended September 30, 2009	
	2008	2008	2009	2008
	(Unaudited)			
<b>Interest income</b>				
Loans	\$ 7,977	\$ 8,720	\$ 23,685	\$ 26,630
Investment securities	1,129	1,282	3,390	3,837
Federal funds sold	9	57	17	238
Total interest income	9,115	10,059	27,092	30,705
<b>Interest expense</b>				
Deposits	2,386	3,531	7,621	11,495
Borrowings	1,779	1,685	5,141	5,195
Total interest expense	4,165	5,216	12,762	16,690
Net interest income	4,950	4,843	14,330	14,015
Provision for loan losses	1,085	650	2,810	1,950
Net interest income after provision for loan losses	3,865	4,193	11,520	12,065
<b>Noninterest income (loss)</b>				
Loan fee income	138	38	297	126
Service fees on deposit accounts	199	177	551	468
Income from bank owned life insurance	213	114	459	312
Gain on sale of securities	34	7	34	7
Other than temporary impairment on investment securities	-	(1,841)	-	(1,841)
Real estate owned activity	(148)	(7)	(152)	(58)
Other income	97	85	277	245
Total noninterest income (loss)	533	(1,427)	1,466	(741)
<b>Noninterest expenses</b>				
Compensation and benefits	1,980	1,625	5,867	5,149
Professional fees	186	127	478	368
Marketing	176	154	495	450
Insurance	352	141	1,143	413

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Occupancy	550	437	1,407	1,134
Data processing and related costs	358	347	1,077	1,012
Telephone	76	50	186	126
Other	187	159	605	560
Total noninterest expenses	3,865	3,040	11,258	9,212
Income (loss) before income tax expense	533	(274)	1,728	2,112
Income tax expense (benefit)	109	(148)	461	630
<b>Net income (loss)</b>	<b>\$ 424</b>	<b>\$ (126)</b>	<b>\$ 1,267</b>	<b>\$ 1,482</b>
Preferred stock dividend to be paid	218	-	512	-
Dividend accretion	127	-	297	-
<b>Net income (loss) available to common shareholders</b>	<b>\$ 79</b>	<b>\$ (126)</b>	<b>\$ 458</b>	<b>\$ 1,482</b>
<b>Earnings (loss) per common share</b>				
Basic	\$ 0.03	\$ (0.04)	\$ 0.15	\$ 0.50
Diluted	\$ 0.03	\$ (0.04)	\$ 0.15	\$ 0.47
<b>Weighted average common shares outstanding</b>				
Basic	3,048,959	3,002,205	3,046,228	2,984,947
Diluted	3,109,708	3,002,205	3,069,794	3,175,274

See notes to consolidated financial statements that are an integral part of these consolidated statements.

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**SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY  
AND COMPREHENSIVE INCOME  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008  
(Unaudited)**

(dollars in thousands, except share data)

	Common stock Shares	Common stock Amount	Preferred stock	Nonvested restricted stock	Additional paid-in capital	Accumulated other comprehensive income(loss)	Retained Earnings	Total shareholders equity
<b>December 31, 2007</b>	2,946,456	\$ 29	\$ -	\$ (41)	\$ 31,034	\$ 96	\$ 7,160	\$ 38,278
Net income	-	-	-	-	-	-	1,482	1,482

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Comprehensive income, net of tax

-								
Unrealized holding loss on securities available for sale	-	-	-	-	-	(2,593)	-	(2,593)
Total comprehensive income	-	-	-	-	-	-	-	(1,111)
Proceeds from exercise of stock options and warrants	69,662	1	-	-	428	-	-	429
Amortization of deferred compensation on restricted stock	-	-	-	11	-	-	-	11
Compensation expense related to stock options, net of tax	-	-	-	-	42	-	-	42
<b>September 30, 2008</b>	<b>3,096,118</b>	<b>\$ 30</b>	<b>\$ -</b>	<b>\$ (30)</b>	<b>\$ 31,504</b>	<b>\$ (2,497)</b>	<b>\$ 8,642</b>	<b>\$ 37,649</b>
<b>December 31, 2008</b>	<b>3,044,863</b>	<b>\$ 30</b>	<b>\$ -</b>	<b>\$ (27)</b>	<b>\$ 31,850</b>	<b>\$ (1,079)</b>	<b>\$ 9,012</b>	<b>\$ 39,786</b>
Net income	-	-	-	-	-	-	1,267	1,267
Comprehensive income, net of tax	-	-	-	-	-	-	-	-
Unrealized holding gain on securities available for sale	-	-	-	-	-	2,069	-	2,069
Total comprehensive income	-	-	-	-	-	-	-	3,336
Preferred stock transactions:								
Proceeds from issuance of 17,299 shares of preferred stock	-	-	15,856	-	-	-	-	15,856
Proceeds from issuance of common stock warrants	-	-	-	-	1,418	-	-	1,418
Cash dividends on Series T preferred at annual dividend rate of 5%	-	-	-	-	-	-	(404)	(404)
Dividend accretion	-	-	(297)	-	297	-	-	-
Proceeds from exercise of stock warrants	24,897	1	-	-	150	-	-	151
Amortization of deferred compensation on restricted stock	-	-	-	10	-	-	-	10
Compensation expense related to stock options	-	-	-	-	79	-	-	79
<b>September 30, 2009</b>	<b>3,069,760</b>	<b>\$ 31</b>	<b>\$ 15,559</b>	<b>\$ (17)</b>	<b>\$ 33,794</b>	<b>\$ 990</b>	<b>\$ 9,875</b>	<b>\$ 60,232</b>

See notes to consolidated financial statements that are an integral part of these consolidated statements.



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	<b>For the nine months ended</b>	
	<b>September 30,</b>	<b>2008</b>
	<b>2009</b>	<b>2008</b>
	(Unaudited)	
<b>Operating activities</b>		
Net income	\$ 1,267	\$ 1,482
Adjustments to reconcile net income to cash provided by (used for) operating activities:		
Provision for loan losses	2,810	1,950
Depreciation and other amortization	494	389
Accretion and amortization of securities discounts and premium, net	286	111
Loss (gain) on sale of real estate	(4)	67
Write-down of real estate owned	202	-
Gain on sale of investment securities	(34)	(7)
Other than temporary impairment on investment securities	-	1,841
Compensation expense related to stock options and grants	89	53
Increase in cash surrender value of bank owned life insurance	(459)	(312)
Decrease (increase) in deferred tax asset	(302)	17
Decrease in other assets, net	243	430
Increase (decrease) in other liabilities, net	(784)	880
Net cash provided by operating activities	3,808	6,901
<b>Investing activities</b>		
Increase (decrease) in cash realized from:		
Origination of loans, net	(9,242)	(55,541)
Purchase of property and equipment	(4,913)	(4,918)
Purchase of investment securities:		
Available for sale	(37,118)	(27,666)
Other investments	(894)	(909)
Payments and maturity of investment securities:		
Available for sale	23,675	17,130
Held to maturity	2,698	1,936
Other investments	266	1,125
Purchase of life insurance policies	-	(2,500)
Proceeds from sale of real estate acquired in settlement of loans	389	47
Net cash used for investing activities	(25,139)	(71,296)
<b>Financing activities</b>		
Increase (decrease) in cash realized from:		
Increase in deposits, net	25,279	65,007
Increase in short-term repurchase agreements, net	5,000	-
Decrease in note payable	(10,250)	-
Increase in Federal Home Loan Bank advances and related debt	-	3,180
Proceeds from the issuance of preferred stock	15,856	-
Proceeds from the issuance of stock warrant	1,418	-
Cash dividend on preferred stock	(404)	-
Proceeds from the exercise of stock options and warrants	151	429
Net cash provided by financing activities	37,050	68,616

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Net increase in cash and cash equivalents	15,719	4,221
<b>Cash and cash equivalents at beginning of the period</b>	13,160	16,971
<b>Cash and cash equivalents at end of the period</b>	\$ 28,879	\$ 21,192
<b>Supplemental information</b>		
<b>Cash paid for</b>		
Interest	\$ 13,052	\$ 17,366
Income taxes	\$ 605	\$ 1,317
<b>Schedule of non-cash transactions</b>		
Real estate acquired in settlement of loans	\$ 4,263	\$ 1,907
Unrealized gain (loss) on securities, net of income taxes	\$ 2,069	\$ (2,593)

See notes to consolidated financial statements that are an integral part of these consolidated statements.

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**SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1. Nature of Business and Basis of Presentation**

*Business activity*

**Southern First Bancshares, Inc.** (the Company) is a South Carolina corporation that owns all of the capital stock of Southern First Bank, N.A. (the Bank) and all of the stock of Greenville First Statutory Trust I and II (collectively the Trusts). On July 2, 2007, the Company and Bank changed their names to Southern First Bancshares, Inc. and Southern First Bank, N.A., respectively. The Bank is a national bank organized under the laws of the United States located in Greenville County, South Carolina. The Bank is primarily engaged in the business of accepting demand deposits and savings deposits insured by the Federal Deposit Insurance Corporation (the FDIC), and providing commercial, consumer and mortgage loans to the general public. The Trusts are special purpose subsidiaries organized for the sole purpose of issuing trust preferred securities.

*Basis of Presentation*

The accompanying financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine-month periods ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December

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31, 2009. For further information, refer to the consolidated financial statements and footnotes thereto included in the company's Form 10-K for the year ended December 31, 2008 (Registration Number 000-27719) as filed with the Securities and Exchange Commission. The consolidated financial statements include the accounts of Southern First Bancshares, Inc., and its wholly owned subsidiary Southern First Bank, N.A. In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 810, Consolidation, the financial statements related to the special purpose subsidiaries, Greenville First Statutory Trust I and Trust II, have not been consolidated.

### *Cash and Cash Equivalents*

For purposes of the Consolidated Statements of Cash Flows, cash and federal funds sold are included in cash and cash equivalents. These assets have contractual maturities of less than three months.

### *Reclassifications*

Certain amounts, previously reported, have been reclassified to state all periods on a comparable basis that had no effect on shareholders' equity or net income.

### *Subsequent Events*

In accordance with FASB ASC 855, Subsequent Events, issued in May 2009 and effective for periods ending after June 15, 2009, management performed an evaluation to determine whether or not there have been any subsequent events since the balance sheet date. The evaluation was performed through November 4, 2009, the date on which the Company's 10-Q was issued as filed with the Securities and Exchange Commission.

### **NOTE 2. Note Payable**

The Company had a \$4.8 million term note with Silverton Bridge Bank, N.A. (Silverton) at September 30, 2009. The note matures on April 30, 2014 and bears interest at the prime rate plus 0.5% with a floor rate of 4.0%. The Company has pledged all of the stock of the Bank as collateral for this note. The loan agreement contains various financial covenants related to net income and asset quality.

**NOTE 3. Preferred Stock Issuance**

On February 27, 2009, as part of the Treasury Department's Capital Purchase Program ( CPP ), the Company entered into a Letter Agreement and a Securities Purchase Agreement (collectively, the CPP Purchase Agreement ) with the Treasury Department, pursuant to which the Company sold 17,299 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series T (the Series T Preferred Stock ) and a warrant (the CPP Warrant ) to purchase 330,554 shares of the Company's common stock for an aggregate purchase price of \$17.3 million in cash. The Series T Preferred Stock qualifies as Tier 1 capital and is entitled to cumulative dividends at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The Company must consult with the Office of the Comptroller of the Currency ( OCC ) before it may redeem the Series T Preferred Stock but, contrary to the original restrictions in the Emergency Economic Stabilization Act of 2008 (the "EESA"), will not necessarily be required to raise additional equity capital in order to redeem this stock. The CPP Warrant has a 10-year term and is immediately exercisable upon its issuance, with an exercise price, subject to anti-dilution adjustments equal to \$7.85 per share of the common stock. The fair value allocation of the \$17.3 million between the shares of Series T Preferred Stock and the CPP Warrant resulted in \$15.9 million allocated to the shares of Series T Preferred Stock and \$1.4 million allocated to the CPP Warrant.

**NOTE 4. Earnings per Common Share**

The following schedule reconciles the numerators and denominators of the basic and diluted earnings per share computations for the three and nine month periods ended September 30, 2009 and 2008 (dollars in thousands, except share data). Dilutive common shares arise from the potentially dilutive effect of the company's stock options and warrants that are outstanding. The assumed conversion of stock options and warrants can create a difference between basic and diluted net income per common share.

At September 30, 2009 and 2008, 442,079 and 59,750 options and warrants, respectively, were anti-dilutive in the calculation of earnings per share as their exercise price exceeded the fair market value.

	<b>Three months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
<b>Numerator:</b>		
Net income (loss)	\$ 424	\$ (126)
Less: Preferred stock dividends to be paid	218	-
Dividend accretion (1)	127	-
Net income (loss) available to common shareholders	\$ 79	\$ (126)
<b>Denominator:</b>		
Weighted-average common shares outstanding basic	3,048,959	3,002,205
Common stock equivalents	60,749	-
Weighted-average common shares outstanding diluted	3,109,708	3,002,205
<b>Earnings (loss) per common share:</b>		
Basic	\$ 0.03	\$ (0.04)
Diluted	\$ 0.03	\$ (0.04)
	<b>Nine months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
<b>Numerator:</b>		
Net income	\$ 1,267	\$ 1,482
Less: Preferred stock dividends to be paid	512	-
Dividend accretion (1)	297	-
Net income available to common shareholders	\$ 458	\$ 1,482

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Denominator:			
Weighted-average common shares outstanding	basic	3,046,228	2,984,947
Common stock equivalents		23,566	190,327
Weighted-average common shares outstanding	diluted	3,069,794	3,175,274
Earnings per common share:			
Basic		\$ 0.15	\$ 0.50
Diluted		\$ 0.15	\$ 0.47

(1) Preferred stock dividend required to be accreted over estimated life of warrant issued in conjunction with preferred stock.

**NOTE 5. Stock Based Compensation**

The Company has a stock-based employee compensation plan. On January 1, 2006, the Company adopted the fair value recognition provisions of FASB ASC 718, Compensation - Stock Compensation, to account for compensation costs under its stock option plan.

In adopting FASB ASC 718, the Company elected to use the modified prospective method to account for the transition from the intrinsic value method to the fair value recognition method. Under the modified prospective method, compensation cost is recognized from the adoption date forward for all new stock options granted and for any outstanding unvested awards as if the fair value method had been applied to those awards as of the date of grant.

The fair value of the option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The following assumptions were used for grants: expected volatility of 26.76% for 2009 and 2008, risk-free interest rate of 3.72% for 2009 and 2008, expected lives of the options were 10 years, and the assumed dividend rate was zero.

**NOTE 6. Fair Value Accounting**

Effective January 1, 2008, the Company adopted FASB ASC 820, Fair Value Measurement and Disclosures, which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. FASB ASC 820 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring or on a nonrecurring basis.

As of June 30, 2009, the Company adopted FASB ASC 820, Fair Value Measurement and Disclosures, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. FASB ASC 820, Fair Value Measurement and Disclosures, is intended to determine the fair value when there is no active market or where the inputs being used represent distressed sales.

FASB ASC 820, Fair Value Measurement and Disclosures, defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

**Level 1**

Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include certain debt and equity securities and derivative contracts that are traded in an active exchange market.

**Level 2**

Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include fixed income securities and mortgage-backed securities that are held in the Company's available-for-sale portfolio, certain derivative contracts and impaired loans.

**Level 3**

Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. These methodologies may result in a significant portion of the fair value being derived from unobservable data.

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Following is a description of valuation methodologies used for assets recorded at fair value.

### *Investment Securities*

Securities available for sale are valued on a recurring basis at quoted market prices where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable securities. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange or U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities and debentures issued by government sponsored entities, municipal bonds and corporate debt securities. In certain cases where there is limited activity or less transparency around inputs to valuations, securities are classified as Level 3 within the valuation hierarchy. Securities held to maturity are valued at quoted market prices or dealer quotes similar to securities available for sale. The carrying value of Other Investments, such as Federal Reserve Bank and Federal Home Loan Bank stock, approximates fair value based on their redemption provisions.

### *Loans*

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan may be considered impaired and an allowance for loan losses may be established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with FASB ASC 310, Receivables. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At September 30, 2009, substantially all of the impaired loans were evaluated based on the fair value of the collateral. In accordance with FASB ASC 820, Fair Value Measurement and Disclosures, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company considers the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company considers the impaired loan as nonrecurring Level 3.

### *Other Real Estate Owned ( OREO )*

OREO, consisting of properties obtained through foreclosure or in satisfaction of loans, is reported at the lower of cost or fair value, determined on the basis of current appraisals, comparable sales, and other estimates of value obtained principally from independent sources, adjusted for estimated selling costs (Level 2). At the time of foreclosure, any excess of the loan balance over the fair value of the real estate held as collateral is treated as a charge against the allowance for loan losses. Gains or losses on sale and generally any subsequent adjustments to the value are recorded as a component of OREO expense.

### *Assets and Liabilities Recorded at Fair Value on a Recurring Basis*

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of September 30, 2009 (dollars in thousands).



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	Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Securities available for sale:			
Government sponsored enterprises	\$ -	\$ 7,497	\$ -
State and political subdivisions	-	4,018	-
Mortgage-backed securities	-	62,468	6,792
Other investments	-	-	9,088
<b>Total</b>	<b>\$ -</b>	<b>\$ 73,983</b>	<b>\$ 15,880</b>

The Company has no liabilities carried at fair value or measured at fair value on a recurring or nonrecurring basis.

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The table below presents a reconciliation for the period of January 1, 2009 to September 30, 2009, for all Level 3 assets that are measured at fair value on a recurring basis (dollars in thousands).

	Collateralized mortgage obligations	Other investments
Beginning balance	\$ 5,213	\$ 8,461
Total realized and unrealized gains or losses:		
Included in earnings	-	-
Included in other comprehensive income	2,259	-
Purchases, sales and principal reductions	(680)	627
Transfers in and/or out of Level 3	-	-
Ending Balance	\$ 6,792	\$ 9,088

*Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis*

The Company is predominantly an asset based lender with real estate serving as collateral on approximately 78.7% of loans. Loans which are deemed to be impaired and real estate acquired in settlement of loans are valued on a nonrecurring basis at the lower of cost or market value of the underlying real estate collateral. Such market values are generally obtained using independent appraisals, which the Company considers to be level 2 inputs. The table below presents the recorded amount of assets and liabilities measured at fair value on a nonrecurring basis as of September 30, 2009 (dollars in thousands).

	<b>Quoted market price in active markets (Level 1)</b>	<b>Significant other observable inputs (Level 2)</b>	<b>Significant unobservable inputs (Level 3)</b>
Impaired loans	\$ -	\$ 9,876	\$ -
Other Real Estate Owned	-	4,093	-

*Fair Value of Financial Instruments*

FASB ASC 825, Financial Instruments, requires disclosure of fair value information, whether or not recognized in the consolidated balance sheets, when it is practical to estimate the fair value. FASB ASC 825 defines a financial instrument as cash, evidence of an ownership interest in an entity or contractual obligations which require the exchange of cash or other financial instruments. Certain items are specifically excluded from the disclosure requirements, including the Company's common stock, premises and equipment and other assets and liabilities.

Following is a description of valuation methodologies used to estimate fair value for certain other financial instruments.

Fair value approximates carrying value for the following financial instruments due to the short-term nature of the instrument: cash and due from banks, federal funds sold, federal funds purchased, securities sold under agreement to repurchase.

*Bank Owned Life Insurance* - The cash surrender value of bank owned life insurance policies held by the Bank approximates fair values of the policies.

*Deposit Liabilities* - Fair value for demand deposit accounts and interest-bearing accounts with no fixed maturity date is equal to the carrying value. The fair value of certificate of deposit accounts are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

*FHLB Advances and Other Borrowings*- Fair value for FHLB advances and other borrowings are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

The Company has used management's best estimate of fair value based on the above assumptions. Thus, the fair values presented may not be the amounts that could be realized in an immediate sale or settlement of the instrument. In addition, any income taxes or other expenses, which would be incurred in an actual sale or settlement, are not taken into consideration in the fair value presented.

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The estimated fair values of the Company's financial instruments at September 30, 2009 and December 31, 2008 are as follows:

	September 30, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial Assets:</b>				
Cash and cash equivalents	\$ 28,879	\$ 28,879	\$ 13,160	\$ 13,160
Investment securities available for sale	80,775	80,775	64,432	64,432
Investment securities held to maturity	9,795	10,132	12,519	12,618
Other investments	9,088	9,088	8,461	8,461
Loans, net	561,771	571,789	559,602	564,573
Bank owned life insurance	13,828	13,828	13,369	13,369
<b>Financial Liabilities:</b>				
Deposits	494,816	465,129	469,537	447,427
Short-term repurchase agreements	5,000	5,000	-	-
Federal Home Loan Bank advances and related debt	149,675	167,994	149,675	158,216
Note payable	4,750	4,875	15,000	15,000
Junior subordinated debentures	13,403	13,403	13,403	13,403

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

*The following discussion reviews our results of operations and assesses our financial condition. You should read the following discussion and analysis in conjunction with the accompanying consolidated financial statements. The commentary should be read in conjunction with the discussion of forward-looking statements, the financial statements and the related notes and the other statistical information included in this report.*

#### DISCUSSION OF FORWARD-LOOKING STATEMENTS

This report contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are based on many assumptions and estimates and are not guarantees of future performance. Although we believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove to be inaccurate. Therefore, we can give no assurance that the results contemplated in the forward-looking statements will be realized. Our actual results may differ materially from those anticipated in any forward-looking statements, as they will depend on many factors about which we are unsure, including many factors which are beyond our control. The words *may*, *would*, *could*, *will*, *expect*, *anticipate*, *believe*, *intend*, *plan*, and *estimate*, as well as similar expressions, are meant to identify such forward-looking statements. Potential risks and uncertainties that could cause our actual results to differ from those anticipated in any forward-looking statements include, but are not limited to, those described in our Form 10-K for the year ended December 31, 2008 under Item 1A- Risk Factors and the following:

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significant increases in competitive pressure in the banking and financial services industries;

changes in the interest rate environment which could reduce anticipated or actual margins;

changes in political conditions or the legislative or regulatory environment;

general economic conditions, either nationally or regionally and especially in our primary service area, becoming less favorable than expected resulting in, among other things, a deterioration in credit quality;

changes occurring in business conditions and inflation;

changes in technology;

changes in deposit flows;

changes in monetary and tax policies;

the adequacy of level of our allowance for loan loss;

the rate of delinquencies and amounts of charge-offs;

the rates of loan growth and the lack of seasoning of our loan portfolio;

increased funding costs due to market illiquidity, increased competition for funding, and/or regulatory requirements;

our ability to retain our existing customers, including our deposit relationships;

adverse changes in asset quality and resulting credit risk-related losses and expenses;

the amount of our real estate-based loans, and the weakness in the commercial real estate market;

loss of consumer confidence and economic disruptions resulting from terrorist activities;

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changes in the securities markets; and

other risks and uncertainties detailed from time to time in our filings with the Securities and Exchange Commission.

We have based our forward looking statements on our current expectations about future events. Although we believe that the expectations reflected in our forward-looking statements are reasonable, we cannot guarantee you that these expectations will be achieved. We undertake no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

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These risks are exacerbated by the recent developments in national and international financial markets, and we are unable to predict what effect these uncertain market conditions will have on our Company. During 2008 and continuing through the third quarter of 2009, the capital and credit markets experienced unprecedented levels of volatility and disruption. There can be no assurance that these unprecedented developments will not materially and adversely affect our business, financial condition and results of operations.

### Overview

We were incorporated in March 1999 to organize and serve as the holding company for Greenville First Bank, N.A. On July 2, 2007, we changed the name of our company and bank to Southern First Bancshares, Inc. and Southern First Bank, N.A., respectively. Since we opened our bank in January 2000, we have experienced growth in total assets, loans, deposits, and shareholders' equity.

Like most community banks, we derive the majority of our income from interest received on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, on which we pay interest. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits and borrowings. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities, which is called our net interest spread.

There are risks inherent in all loans, so we maintain an allowance for loan losses to absorb probable losses on existing loans that may become uncollectible. We maintain this allowance by charging a provision for loan losses against our operating earnings for each period. We have included a detailed discussion of this process, as well as several tables describing our allowance for loan losses.

In addition to earning interest on our loans and investments, we earn income through fees and other charges to our customers. We have also included a discussion of the various components of this noninterest income, as well as of our noninterest expense.

Economic conditions, competition, and the monetary and fiscal policies of the Federal government significantly affect most financial institutions, including Southern First. Lending and deposit activities and fee income generation are influenced by levels of business spending and investment, consumer income, consumer spending and savings, capital market activities, and competition among financial institutions, as well as customer preferences, interest rate conditions and prevailing market rates on competing products in our market areas.

Our business model continues to be client-focused, utilizing relationship teams to provide our clients with a specific banker contact and support team responsible for all of their banking needs. The purpose of this structure is to provide a consistent and superior level of professional service, and we believe it provides us with a distinct competitive advantage. We consider exceptional client service to be a critical part of our culture, which we refer to as ClientFIRST.

The following discussion and analysis also identifies significant factors that have affected our financial position and operating results during the periods included in the accompanying financial statements. We encourage you to read this discussion and analysis in conjunction with our financial statements and the other statistical information included in our filings with the Securities and Exchange Commission.

## **Critical Accounting Policies**

We have adopted various accounting policies that govern the application of accounting principles generally accepted in the United States and with general practices within the banking industry in the preparation of our financial statements. Our significant accounting policies are described in the footnotes to our audited consolidated financial statements as of December 31, 2008, as filed in our Annual Report on Form 10-K.

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Certain accounting policies involve significant judgments and assumptions by us that have a material impact on the carrying value of certain assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgment and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgment and assumptions we make, actual results could differ from these judgments and estimates that could have a material impact on the carrying values of our assets and liabilities and our results of operations.

### ***Allowance for Loan Losses***

We believe the allowance for loan losses is the critical accounting policy that requires the most significant judgment and estimates used in preparation of our consolidated financial statements. Some of the more critical judgments supporting the amount of our allowance for loan losses include judgments about the credit worthiness of borrowers, the estimated value of the underlying collateral, assumptions about cash flow, determination of loss factors for estimating credit losses, and the impact of current events, conditions, and other factors impacting the level of probable inherent losses. Under different conditions, the actual amount of credit losses incurred by us may be different from management's estimates provided in our consolidated financial statements. Refer to the portion of this discussion that addresses our allowance for loan losses for a more complete discussion of our processes and methodology for determining our allowance for loan losses.

### ***Real Estate Acquired in Settlement of Loans***

Real estate acquired through foreclosure is initially recorded at the lower of cost or estimated fair value. Subsequent to the date of acquisition, it is carried at the lower of cost or fair value, adjusted for net selling costs. Fair values of real estate owned are reviewed regularly and writedowns are recorded when it is determined that the carrying value of real estate exceeds the fair value less estimated costs to sell. Costs relating to the development and improvement of such property are capitalized, whereas those costs relating to holding the property are expensed.

### ***Income Taxes***

The financial statements have been prepared on the accrual basis. When income and expenses are recognized in different periods for financial reporting purposes versus for the purposes of computing income taxes currently payable, deferred taxes are provided on such temporary differences. The Company accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes* and FASB Interpretation No. 48 ( *FIN 48* ), *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*. Under SFAS No. 109 and FIN 48, deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been recognized in the consolidated financial statements or tax returns. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled. The Company believes that its income tax filing positions taken or expected to be taken in its tax returns will more likely than not be sustained upon audit by the taxing authorities and does not anticipate any adjustments that will result in a material adverse impact on the Company's financial condition, results of operations, or cash flow. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to FIN 48.

### **Effect of Economic Trends**

The first nine months of 2009 continue to reflect the tumultuous economic conditions which have negatively impacted liquidity and credit quality. Concerns regarding increased credit losses from the weakening economy have negatively affected capital and earnings of most financial institutions. Financial institutions have experienced significant declines in the value of collateral for real estate loans, heightened credit losses, which have resulted in record levels of non-performing assets, charge-offs and foreclosures. In addition, certain financial institutions failed or merged with other institutions during 2008 and during the first nine months of 2009, and two of the government sponsored housing enterprises were placed into conservatorship with the U.S. Government.

Liquidity in the debt markets remains low in spite of efforts by the U.S. Department of the Treasury ( *Treasury* ) and the Federal Reserve Bank ( *Federal Reserve* ) to inject capital into financial institutions. The federal funds rate set by the Federal Reserve has remained at 0.25% since December 2008, following a decline from 4.25% to 0.25% during 2008 through a series of seven rate reductions.

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Treasury, the FDIC and other governmental agencies continue to enact rules and regulations to implement the EESA, the Troubled Asset Relief Program ( *TARP* ), the Financial Stability Plan, the American Recovery and Reinvestment Act ( *ARRA* ) and related economic recovery programs, many of which contain limitations on the ability of financial institutions to take certain actions or to engage in certain activities if the financial institution is a participant in the TARP Capital Purchase Program or related programs. Future regulations, or enforcement of the terms of programs already in place, may require financial institutions to raise additional capital and result in the conversion of preferred equity issued under TARP or other programs to common equity. There can be no assurance as to the actual impact of the EESA, the FDIC programs or any other governmental program on the financial markets.

The weak economic conditions are expected to continue through the remainder of 2009. Financial institutions likely will continue to experience heightened credit losses and higher levels of non-performing assets, charge-offs and foreclosures. In light of these conditions, financial institutions also face heightened levels of scrutiny from federal and state regulators. These factors negatively influenced, and likely will continue to negatively influence, earning asset yields at a time when the market for deposits is intensely competitive. As a result, financial institutions experienced, and are expected to continue to experience, pressure on credit costs, loan yields, deposit and other borrowing costs, liquidity, and capital.

**Recent Legislative and Regulatory Initiatives to Address Financial and Economic Crises**

Markets in the United States and elsewhere have experienced extreme volatility and disruption for more than 12 months. These circumstances have exerted significant downward pressure on prices of equity securities and virtually all other asset classes, and have resulted in substantially increased market volatility, severely constrained credit and capital markets, particularly for financial institutions, and an overall loss of investor confidence. Loan portfolio performances have deteriorated at many institutions resulting from, among other factors, a weak economy and a decline in the value of the collateral supporting their loans. Dramatic slowdowns in the housing industry, due in part to falling home prices and increasing foreclosures and unemployment, have created strains on financial institutions. Many borrowers are now unable to repay their loans, and the collateral securing these loans has, in some cases, declined below the loan balance. In response to the challenges facing the financial services sector, several regulatory and governmental actions have recently been announced including:

The EESA, approved by Congress and signed by President Bush on October 3, 2008, which, among other provisions, allowed the Treasury Department to purchase troubled assets from banks, authorized the Securities and Exchange Commission to suspend the application of marked-to-market accounting, and raised the basic limit of FDIC deposit insurance from \$100,000 to \$250,000 through December 31, 2013;

On October 7, 2008, the FDIC approved a plan to increase the rates banks pay for deposit insurance;

On October 14, 2008, the U.S. Treasury announced the creation of the CPP which encourages and allows financial institutions to build capital through the sale of senior preferred shares to the Treasury Department on terms that are non-negotiable;

On October 14, 2008, the FDIC announced the creation of the Temporary Liquidity Guarantee Program ( TLGP ), which seeks to strengthen confidence and encourage liquidity in the banking system. The TLGP has two primary components that are available on a voluntary basis to financial institutions:

The Transaction Account Guarantee Program ( TAGP ), which provides unlimited deposit insurance coverage for noninterest-bearing transaction accounts (typically business checking accounts) and certain funds swept into noninterest-bearing savings accounts. The FDIC has extended the TAGP until June 30, 2010. Institutions participating in the TLGP pay a 10 basis points fee (annualized) on the balance of each covered account in excess of \$250,000, while the extra deposit insurance is in place;

The Debt Guarantee Program ( DGP ), under which the FDIC guarantees certain senior unsecured debt of FDIC-insured institutions and their holding companies. The unsecured debt must be issued on or after October 14, 2008 and not later than June 30, 2009, and the guarantee is effective through the earlier of the maturity date or June 30, 2012. The DGP coverage limit is generally 125% of the eligible entity's eligible debt outstanding on September 30, 2008 and scheduled to mature on or before June 30, 2009 or, for certain insured institutions, 2% of their liabilities as of September 30, 2008. Depending on the term of the debt maturity, the nonrefundable DGP fee ranges from 50 to 100 basis points (annualized) for covered debt outstanding until the earlier of maturity or June 30, 2012. The TAGP and DGP are in effect for all eligible entities, unless the entity opted out on or before December 5, 2008.



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On February 17, 2009, the American Recovery and Reinvestment Act (ARRA) was signed into law in an effort to, among other things, create jobs and stimulate growth in the United States economy. The ARRA specifies appropriations of approximately \$787 billion for a wide range of Federal programs and will increase or extend certain benefits payable under the Medicaid, unemployment compensation, and nutrition assistance programs. The Recovery Act also reduces individual and corporate income tax collections and makes a variety of other changes to tax laws. The ARRA also imposes certain limitations on compensation paid by participants in the U.S. Treasury's Troubled Asset Relief Program.

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On March 23, 2009, the U.S. Treasury, in conjunction with the FDIC and the Federal Reserve, announced the Public-Private Partnership Investment Program for Legacy Assets which consists of two separate plans, addressing two distinct asset groups:

The Legacy Loan Program facilitates the sale of troubled mortgage loans by eligible institutions, which include FDIC-insured federal or state banks and savings associations. Eligible assets may not be strictly limited to loans; however, what constitutes an eligible asset will be determined by participating banks, their primary regulators, the FDIC and the U.S. Treasury. The first sale under this Program was made in the third quarter of 2009.

The Securities Program, which is administered by the U.S. Treasury, involves the creation of public-private investment funds to target investments in eligible residential mortgage-backed securities and commercial mortgage-backed securities issued before 2009 that originally were rated AAA or the equivalent by two or more nationally recognized statistical rating organizations, without regard to rating enhancements (collectively, Legacy Securities). Legacy Securities must be directly secured by actual mortgage loans, leases or other assets, and may be purchased only from financial institutions that meet TARP eligibility requirements.

In response to the above regulatory initiatives, we entered into the CPP Purchase Agreement with the Treasury Department on February 27, 2009, pursuant to which we sold 17,299 shares of our Series T Preferred Stock and the CPP Warrant to purchase 330,554 shares of our common stock for an aggregate purchase price of \$17.3 million in cash. The Series T Preferred Stock qualifies as Tier 1 capital and is entitled to cumulative dividends at a rate of 5% per annum for the first five years, and 9% per annum thereafter. We must consult with the OCC before we may redeem the Series T Preferred Stock but, contrary to the original restrictions in the EESA, will not necessarily be required to raise additional equity capital in order to redeem this stock. The CPP Warrant has a 10-year term and is immediately exercisable upon its issuance, with an exercise price, subject to anti-dilution adjustments equal to \$7.85 per share of the common stock. The fair value allocation of the \$17.3 million between the shares of Series T Preferred Stock and the CPP Warrant resulted in \$15.9 million allocated to the shares of Series T Preferred Stock and \$1.4 million allocated to the CPP Warrant.

We have chosen to participate in the TAGP through June 30, 2010 and have opted out of the DGP.

### RESULTS OF OPERATIONS

*Summary*

*Three months ended September 30, 2009 and 2008*

Our net income was \$424,000 for the three months ended September 30, 2009, an increase of \$550,000, over a net loss of \$126,000 for the same period in 2008. The increase in net income resulted primarily from the \$1.8 million pre-tax impairment charge on Fannie Mae preferred stock during the three months ended September 30, 2008. Partially offsetting the impairment charge were increases of \$825,000 in noninterest expenses, \$435,000 in provision for loan losses, and \$257,000 in income tax expense. Our efficiency ratio, excluding real estate owned activity and the impairment charge, was 69.1% for the three months ended September 30, 2009 compared to 57.8% for the same period in 2008. The higher efficiency ratio relates primarily to the additional FDIC insurance costs during the third quarter of 2009 as well as administrative costs associated with our two new retail offices.

*Nine months ended September 30, 2009 and 2008*

Our net income was \$1.3 million and \$1.5 million for the nine months ended September 30, 2009 and 2008, respectively, a decrease of \$215,000, or 14.5%. The decrease in net income resulted primarily from increases of \$2.1 million in noninterest expenses and \$860,000 in the provision for loan losses, partially offset by increases of \$315,000 in net interest income and \$2.2 million in noninterest income and a decrease of \$169,000 in income tax expense. Our efficiency ratio, excluding real estate owned activity and the impairment charge, was 70.8% for the nine months ended September 30, 2009 from 60.8% for the same period in 2008. The higher efficiency ratio relates primarily to the additional FDIC insurance costs during 2009 as well as administrative costs associated with our two new retail offices.

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*Net Interest Income*

Our level of net interest income is determined by the level of earning assets and the management of our net interest margin. For the three months ended September 30, 2009 and 2008, our net interest income was \$5.0 million and \$4.8 million, respectively. Our average earning assets increased \$30.8 million during the three months ended September 30, 2009 compared to the average for the three months ended September 30, 2008, while our interest bearing liabilities increased only \$15.4 million. The lesser increase in average interest bearing liabilities is due to the utilization of \$17.3 million received for the issuance of preferred stock under the Treasury's Capital Purchase Program.

Our net interest income was \$14.3 million and \$14.0 million for the nine month periods ended September 30, 2009 and 2008, respectively. During the nine months ended September 30, 2009, our average earning assets increased \$27.6 million and our average interest bearing liabilities increased \$21.0 million compared to the nine months ended September 30, 2008. The increase in average earning assets is primarily related to a \$25.2 million increase in our average loans, while the increase in average interest-bearing liabilities is related to an increase in our time deposits, specifically, wholesale certificates of deposit.

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We have included a number of tables to assist in our description of various measures of our financial performance. For example, the Average Balances, Income and Expenses, Yields and Rates table shows the average balance of each category of our assets and liabilities as well as the yield we earned or the rate we paid with respect to each category during the three and nine month periods ended September 30, 2009 and 2008. A review of this table shows that our loans typically provide higher interest yields than do other types of interest-earning assets, which is why we direct a substantial percentage of our earning assets into our loan portfolio. Similarly, the Rate/Volume Analysis table demonstrates the effect of changing interest rates and changing volume of assets and liabilities on our financial condition during the periods shown. We also track the sensitivity of our various categories of assets and liabilities to changes in interest rates, and we have included tables to illustrate our interest rate sensitivity with respect to interest-earning accounts and interest-bearing accounts. Finally, we have included various tables that provide detail about our investment securities, our loans, our deposits, and other borrowings.

The following tables set forth information related to our average balance sheets, average yields on assets, and average costs of liabilities (dollars in thousands). We derived these yields by dividing income or expense by the average balance of the corresponding assets or liabilities. We derived average balances from the daily balances throughout the periods indicated. During the three month and nine month periods ended September 30, 2009 and 2008, we had only \$100,000 in interest-bearing deposits at another bank and had no securities purchased with agreements to resell. All investments owned have an original maturity of over one year. Nonaccrual loans are included in the following tables. Loan yields have been reduced to reflect the negative impact on our earnings of loans on nonaccrual status. The net of capitalized loan costs and fees are amortized into interest income on loans.

### Average Balances, Income and Expenses, Yields and Rates For the Three Months Ended September 30,

	2009			2008		
	Average Balance	Income/ Expense	Yield/ Rate(1)	Average Balance	Income/ Expense	Yield/ Rate(1)
<b>Earnings</b>						
Federal funds sold	\$ 18,228	\$ 9	0.20%	\$ 11,684	\$ 57	1.94%
Investment securities, taxable	96,754	1,093	4.48%	90,420	1,246	5.48%
Investment securities, nontaxable (2)	3,774	58	6.10%	3,689	60	6.44%
Loans	570,244	7,977	5.55%	552,450	8,720	6.28%
Total interest-earning assets	689,000	9,137	5.26%	658,243	10,083	6.09%
Noninterest-earning assets	39,539			29,767		
Total assets	\$ 728,539			\$ 688,010		
<b>Interest-bearing liabilities</b>						
NOW accounts	\$ 44,001	77	0.69%	\$ 41,363	99	0.95%
Savings & money market	86,181	241	1.11%	91,634	398	1.73%
Time deposits	317,059	2,068	2.59%	303,476	3,034	3.98%
Total interest-bearing deposits	447,241	2,386	2.12%	436,473	3,531	3.22%
Note payable and other borrowings	164,318	1,681	4.06%	159,713	1,513	3.77%
Junior subordinated debentures	13,403	98	2.90%	13,403	172	5.11%
Total interest-bearing liabilities	624,962	4,165	2.64%	609,589	5,216	3.40%
Noninterest-bearing liabilities	43,436			39,368		
Shareholders' equity	60,141			39,053		
Total liabilities and shareholders' equity	\$ 728,539			\$ 688,010		
Net interest spread			2.62%			2.69%
Net interest income (tax equivalent) / margin		\$ 4,972	2.86%		\$ 4,867	2.94%
Less: tax-equivalent adjustment (2)		22			24	
Net interest income		\$ 4,950			\$ 4,843	

(1) Annualized for the three month period.

(2) The tax-equivalent adjustment to net interest income adjusts the yield for assets earning tax-exempt income to a comparable yield on a taxable basis.

Our net interest margin is calculated as net interest income, on an annualized basis, divided by average interest-earning assets. Our net interest margin, on a tax-equivalent basis, for the three months ended September 30, 2009 was 2.86% compared to 2.94% for the three months ended September 30, 2008. During the third quarter of 2009, interest-earning assets averaged \$689.0 million compared to \$658.2 million in the third quarter of 2009.

Our net interest spread was 2.62% for the three months ended September 30, 2009 compared to 2.69% for the three months ended September 30, 2008. The net interest spread is the difference between the yield we earn on our interest-earning assets and the rate we pay on our interest-bearing liabilities.

The 7 basis point decrease in the net interest spread is primarily due to the fact that more of our rate-sensitive assets repriced downward than our rate-sensitive liabilities during the twelve months ended September 30, 2009. Given the 500 basis point decrease in short-term rates over the past two years, the rates on our new and maturing loans and deposits are much lower than they were in the past. However, in response to the significant decrease in rates, we began instituting interest rate floors on our new and maturing loans during the second half of 2008 and have recently changed our focus to increasing the amount of variable rate loans in our portfolio. Our variable rate loans as a percentage of total loans increased from 42% at September 30, 2008 to 50% at September 30, 2009. We believe that interest rates are at or near their lowest levels and that this change in focus will position us to benefit from future increases in the short-term rates.

Despite a 175 basis point decline in short-term rates in the past 12 months, our loan yield decreased only 73 basis points for the three months ended September 30, 2009 compared to the three months ended September 30, 2008. Offsetting the decrease in our loan yield was a 110 basis point decrease in the cost of our interest-bearing deposits for the third quarter of 2009 compared to the same period in 2008, primarily related to the cost of our time deposits which have renewed at rates much lower than their original rates. In addition, our investment and federal funds sold yields combined decreased by 123 basis points for the 2009 period compared to the same three months in 2008.

The cost of our borrowings, specifically our junior subordinated debt, has declined in the third quarter of 2009 compared to the same period in 2008 due to the variable rates of the debt. As of September 30, 2009, all of our FHLB advances were at fixed rates, while all of our other borrowings, including notes payable and junior subordinated debt, had variable rates.

The \$9.8 million increase in average noninterest-earning assets during the three months ended September 30, 2009 compared to the same period in 2008 is due primarily to a \$6.5 million increase in property and equipment related to the construction of our new regional headquarters facility in Columbia, SC. In addition, the \$21.1 million increase in average shareholders' equity during the 2009 period is primarily related to the \$17.3 million received for the issuance of preferred stock under the Treasury's Capital Purchase Program.

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**Average Balances, Income and Expenses, Yields and Rates**

**For the Nine Months Ended September 30,**

**2009**

**2008**

	<b>Average Balance</b>	<b>Income/ Expense</b>	<b>Yield/ Rate(1)</b>	<b>Average Balance</b>	<b>Income/ Expense</b>	<b>Yield/ Rate(1)</b>
<b>Earnings</b>						
Federal funds sold	\$ 12,713	\$ 17	0.18%	\$ 13,805	\$ 238	2.30%
Investment securities, taxable	95,357	3,282	4.61%	91,935	3,729	5.42%
Investment securities, nontaxable (2)	3,791	174	6.16%	3,746	174	6.21%
Loans	567,921	23,685	5.59%	542,729	26,630	6.55%
Total interest earning assets	679,782	27,158	5.36%	652,215	30,771	6.30%
Non-interest earning assets	38,153			25,607		
Total assets	\$ 717,935			\$ 677,822		
<b>Interest bearing liabilities</b>						
NOW accounts	\$ 43,015	220	0.69%	\$ 39,135	318	1.09%
Savings & money market	85,639	723	1.13%	90,125	1,331	1.97%
Time deposits	317,516	6,678	2.82%	300,373	9,846	4.38%
Total interest-bearing deposits	446,170	7,621	2.29%	429,633	11,495	3.57%
Note payable and other borrowings	162,489	4,803	3.96%	157,991	4,626	3.91%
Junior subordinated debentures	13,403	338	3.38%	13,403	569	5.67%
Total interest bearing liabilities	622,062	12,762	2.75%	601,027	16,690	3.71%
Non-interest bearing liabilities	40,803			37,447		
Shareholders equity	55,070			39,348		
Total liabilities and shareholders equity	\$ 717,935			\$ 677,822		
Net interest spread			2.61%			2.59%
Net interest income (tax equivalent) / margin		\$ 14,396	2.84%	\$ 14,081		2.88%
Less: tax-equivalent adjustment (2)		66		66		
Net interest income / margin	\$	14,330		\$	14,015	

(1) Annualized for the nine month period.

(2) The tax-equivalent adjustment to net interest income adjusts the yield for assets earning tax-exempt income to a comparable yield on a taxable basis.

Our net interest margin, on a tax-equivalent basis, for the nine months ended September 30, 2009 was 2.84% compared to 2.88% for the nine months ended September 30, 2008. During the first nine months of 2009, interest-earning assets averaged \$679.8 million compared to \$652.2 million during the same period of 2008. Our net interest spread, was 2.61% for the nine months ended September 30, 2009 compared to 2.59% for the nine months ended September 30, 2008.

The slight increase in the net interest spread is primarily due to the fact that more of our rate-sensitive liabilities repriced downward than our rate-sensitive assets during the twelve months ended September 30, 2009. Given the 500 basis point decrease in short-term rates over the past two years, the rates on our new and maturing loans and deposits are much lower than they were in the past. However, in response to the significant decrease in rates, we have begun instituting interest rate floors on our new and maturing loans and have recently changed our focus to increasing the amount of variable rate loans in our portfolio. We believe that interest rates are at or near their lowest levels and that this change in focus will position us to benefit from future increases in the short-term rates.

Despite a 175 basis point decline in short-term rates in the past 12 months, our loan yield decreased only 96 basis points for the nine months ended September 30, 2009 compared to the same period in 2008. Offsetting the decrease in our loan yield was a 128 basis point decrease in the

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cost of our interest-bearing deposits for the first nine months of 2009 compared to the nine months ended September 30, 2008, primarily related to the cost of our time deposits which have renewed at rates much lower than their original rates. In addition, our investment and federal funds sold yields combined decreased by 90 basis points for the 2009 period compared to the same three months in 2008.

The cost of our borrowings, specifically our junior subordinated debt, has declined during the nine month period ended September 30, 2009 compared to the same period in 2008 due to the variable rates of the debt. As of September 30, 2009, all of our FHLB advances were at fixed rates, while all of our other borrowings, including notes payable and junior subordinated debt, had variable rates.

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The \$12.6 million increase in noninterest-earning assets during the nine months ended September 30, 2009 compared to the same period in 2008 is due primarily to a \$6.6 million increase in property and equipment related to the construction of our new regional headquarters facility in Columbia, SC as well as increases of \$4.0 million in bank-owned life insurance and \$2.2 million in other real estate owned. In addition, the \$15.7 million increase in average shareholders' equity during the 2009 period is primarily related to the \$17.3 million received on February 27, 2009 for the issuance of preferred stock under the Treasury's Capital Purchase Program.

### *Rate/Volume Analysis*

Net interest income can be analyzed in terms of the impact of changing interest rates and changing volume. The following tables set forth the effect which the varying levels of interest-earning assets and interest-bearing liabilities and the applicable rates have had on changes in net interest income for the periods presented (dollars in thousands).

	<b>Three Months Ended September 30, 2009 vs. 2008 Increase (Decrease) Due to</b>				<b>September 30, 2008 vs. 2007 Increase (Decrease) Due to</b>			
	<b>Volume</b>	<b>Rate</b>	<b>Rate/ Volume</b>	<b>Total</b>	<b>Volume</b>	<b>Rate</b>	<b>Rate/ Volume</b>	<b>Total</b>
<b>Interest income</b>								
Loans	\$ 273	\$ (984)	\$ (32)	\$ (743)	\$ 1,631	\$ (1,719)	\$ (289)	\$ (377)
Investment securities	86	(224)	(15)	(153)	185	(8)	(1)	176
Federal funds sold	32	(51)	(29)	(48)	77	(49)	(48)	(20)
Total interest income	391	(1,259)	(76)	(944)	1,893	(1,776)	(338)	(221)
<b>Interest expense</b>								
Deposits	108	(1,216)	(37)	(1,145)	1,285	(1,347)	(423)	(485)
Note payable and other	45	120	3	168	315	(309)	(58)	(52)
Junior subordinated debt	-	(74)	-	(74)	(33)	(80)	9	(104)
Total interest expense	153	(1,170)	(34)	(1,051)	1,567	(1,736)	(472)	(641)

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Net interest income    \$ 238        \$ (89)        \$ (42)        \$ 107        \$ 326        \$ (40)        \$ 134        \$ 420

**Nine Months Ended  
September 30, 2009 vs. 2008  
Increase (Decrease) Due to**

**September 30, 2008 vs. 2007  
Increase (Decrease) Due to**

**Volume                      Rate**

**Rate/  
Volume**